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THE CONTROL OF PUBLIC SERVICE CORPORATIONS. FINANCIAL CONTROL—CAPITALIZATION.

Address of BIRD S. COLER, Comptroller of the City of New York.

Overcapitalization of corporations is frequently resorted to as a means to cover up exorbitant profits. Parsons, in his admirable book entitled "The City for the People," defines overcapitalization as "the twin sister of extortion," and says that "both arise naturally from the desire to squeeze as much wealth as possible out of the people and keep the people quiet during the process. Get a franchise, issue a lot of stock, keep enough of it to retain control of the enterprise, sell the rest, build your plant, bond it for all it is worth and recoup all you put into the concern, then double up the stock and keep adding to it as the business grows, so that an actual profit of 20, 50 or 100 per cent on the real investment will be only 5 or 6 or 7 per cent on the bonds and stock, and so *appear on the face of the accounts* to be only a reasonable profit, not likely to arouse opposition or set in motion the legislative or administrative machinery for the reduction of the rates—this is the normal monopolistic plan."

In this connection it may be mentioned that a special committee of the Assembly of the State of New York appointed in 1895 recommended bills limiting capitalization of public service companies to one and one-half times the cost of construction, and providing for decreased charges for service whenever 5 per cent on capital was earned.

The capitalization of public service corporations becomes of great moment to the municipality exercising control where the cash return to the municipality is based upon the net earnings of the corporation. Fortunately we have few instances of this in our municipality, and every case is constant source of trouble to the city.

The Dry Dock, East Broadway and Battery Railroad, which pays to the city of New York 5 per cent on net proceeds of the Grand Street branch only, and a portion of the system of the Manhattan Elevated Railroad, which is chargeable with 5 per cent of its net receipts, are the only corporations which pay a franchise tax based upon net profits. Others pay a certain percentage of their gross receipts, which under the Act of 1884, amounts to 3 per cent of the gross receipts for the first five years and 5 per cent thereafter in cities with a population of two hundred and fifty thousand or over. In smaller towns the local authorities may require a maximum of 3 per cent of gross receipts. Still others pay a license fee of fifty or twenty-five dollars per car, and in a few cases charters were granted by the legislature without compensation, or providing for a small fixed payment, as in the case of the Houston Street, West Street and Pavonia Ferry, where one thousand dollars per annum is the sum stipulated, although this company also pays car fees of fifty dollars per car.

The management of ferries belongs to the Department of Docks and Ferries, subject to the supervisory control of the Commissioners of the Sinking Fund, who must lease them on competitive bids for not over ten years at a time. Some of our ferries pay as franchise tax, certain percentages of their gross receipts, others fixed sums besides wharf rent. The compensation for other privileges granted by the city is variously arranged; pipe line franchises being leased at fixed rentals, while gas and steam companies pay either a certain percentage on gross revenue obtained from all public and private customers, or a small amount per foot for each lineal foot of mains and pipes laid. This latter provision for compensation, in the case of the New York Steam Company, is limited so that when \$150,000 has been paid in by the company to the city, the franchise shall have been considered to be paid in full.

In the case of the Consolidated Telegraph and Electrical

Subway Company and the Empire City Subway Company, the company is obligated to pay to the city treasury all its net earnings in excess of 10 per cent cumulative upon the actual cash capital invested by it in providing, constructing and equipping its subways. In connection with this company, it is interesting to note that its sworn returns for the years 1893, 1894, 1895 and 1896 show that in every instance the net income is less than $2\frac{1}{2}$ per cent of the cost of construction as stated. As the company is entitled to 10 per cent cumulative upon its cash capital invested, the chance of the city obtaining something in return for the franchise given is indeed remote. The compensation for street vault privileges is usually fixed at a certain price per square foot of space occupied. It appears, therefore, that in this city there is a great variety in the method of requiring compensation for franchises granted.

If the policy of basing the city's revenue upon the entire gross receipts of public service corporations could be universally adopted and adhered to, there would seem to be little necessity for anxiety or concern in regard to the question of capitalization, excepting where a readjustment of percentages is deemed necessary, or municipal ownership of these corporations is proposed.

Touching this matter of municipal ownership in connection with the subject of capitalization, it is interesting to note that some of the early charters contain provisions allowing the city of New York to acquire roads at their actual cost after a certain time. In such cases it becomes an interesting question how the actual cost is to be ascertained. It certainly should not be determined by the promulgated capital of the concern.

Mayor Grace in vetoing the franchises of the cable railway in 1886, stated that in 1884 the capital of the surface railways in operation was \$15,707,753, and the bonded debt, \$11,266,665; that in that year $14\frac{1}{2}$ per cent dividends on the average had been paid on the capital and 6 8-10 per cent

interest on the bonds, and he declared it more than a fair assumption to place the actual cost of their construction and equipment at the aggregate of their bonded indebtedness, so that on this basis the dividends and interest paid would represent a return of 27 per cent on the bona fide investment.

The Supreme Court of the United States (148 U. S., pp. 312, 327), in referring to the subject of determining the amount of capitalization in order to ascertain the fair valuation of a plant, the purchase of which is contemplated, made the following declaration: "The value of property, generally speaking, is determined by its productiveness and profits which the use brings to the owner; the value is not determined by the mere cost of construction." In another case in Pennsylvania (144 Pa. St. 365, 374 and 375), decided in 1891, the court said: "Value is to be ascertained not only by the cost of the structure, but also by the value of the franchise. The value of the company's franchise depends largely on its earning capacity."

By the Massachusetts Lighting Law, which provides for municipal purchase of gas and electric plants, the price of the property "shall be its market value for the purposes of its use (no portion of such plant to be estimated, however, at less than its fair market value for any other purpose), including as an element of value the earning capacity of such plant based upon the actual earnings being derived from such use at the time of the final vote. Such value shall be estimated without enhancement on account of future earning capacity or good will or of exclusive privileges derived from rights in the public streets."

The Hon. Henry Winn, a high authority, views this matter in a different light. He gives it as his opinion that the people should pay only for what they get in tangible property and private rights not derived free from the public, and not for the franchise. I recall the following quotation from Bemis' "Municipal Monopolies": "The question of compensation for franchises is one of the most difficult in

the whole range of municipal laws. Happy is the city or town that can solve the problem by keeping its franchises from the start or by putting conditions in the franchise grants securing fair rates and good services and providing that after ten, twenty or thirty years the whole property, franchise and physical plant, in good condition, shall become public property without further compensation." Durand, in his work on the Finances of New York City, calls attention to the fact that the experience of foreign cities with railways and lighting plants, and especially the success of municipal ownership of these enterprises, has been largely cited by the advocates of reform. In Berlin, for instance, the Consolidated Railway Company, besides having made large cash payments for the original franchises, pays $8\frac{1}{2}$ per cent of its gross receipts, reimburses the city for paving and cleaning between its tracks, and in 1911 the entire system will become the property of the city without cost.

In many other continental cities a similar provision for reversion of the tracks to the public exists. The absurd practice of granting perpetual franchises is almost unknown. The same is true in Great Britain. Manchester, Birmingham and a large number of other cities own the tracks and lease them to private companies at very favorable terms, while half a dozen or more cities, the most important being Glasgow and Bradford, actually operate the systems by municipal employes and with marked success. Many of the English cities alike own and operate lighting plants, and though furnishing service at rates much lower than are common, would succeed in earning a handsome net revenue. The fact cannot be overlooked, however, that the conditions of employment in the civil service of these cities is very different from what exists in this country, and that it is far more favorable to the practical success of operation of business enterprises by municipalities. The city of New York would seem to have achieved a large measure of success in respect to conserving to the public the value of public

franchises in its scheme for the construction of the great subway of the Rapid Transit Railroad.

And now let me say a few words as to methods of accounting. As has been stated before, so long as public service corporations pay to municipalities granting them their franchises a compensation based upon the entire gross receipts, the municipality need not concern itself with the matter of the company's capitalization, but it oftentimes happens that revaluations of these privileges become necessary, and in these days of municipal reform and progress, the acquisition by purchase by the municipality of the privileges and plant is likely at any time to be carried into effect.

It becomes then, a matter of importance that the books of account of all public service corporations should contain a true, perfect and complete record of their finances, so that reliable statements of financial status can easily be extracted therefrom. As a means to this most desirable end, I am inclined to favor, first—uniformity of accounting methods to be prescribed by the comptroller for corporations engaged in the same business as, for instance, street railroads, gas and electric illuminating companies, etc.; and, second—that these books of account should, at all reasonable times, be open to the inspection of the comptroller or his representative. While I favor this restriction upon public service corporations, I would go further and welcome legislation which would provide for financial statements certified by disinterested accountants and a strict official scrutiny of the accounts of all corporations, the stock and bonds of which are offered as an investment to the general public.

Speaking broadly, the books should be so kept that revenue of every kind and nature, and the sources thereof, will be clearly shown, and that disbursements will be classified as operating or capital expenditures. A sharp distinction should also be made between extensions of plant and renewals, replacements and ordinary repairs. Too often is it the case that expenditures for renewals of plant are added to

the "plant account," with absolutely no deduction for loss, nor any allowance for deterioration. True inventories frequently give the lie to apparently well kept book accounts.

How shall the city be compensated for these valuable franchises? As to railroads, our own state law provides for a sale at auction to the bidder offering the highest percentage of gross receipts, in no case to be less than the three and five per cent minimum previously fixed, and in some of our ferry leases the minimum sum to which these gross receipt percentages shall amount to, is fixed. In some respects, this method of taxation is desirable because it is easy of computation and proof, and is fair alike to the public corporation and to the municipality itself.

In the State of New York there is a genuine and rapidly growing popular interest in these matters, which was responsible for the enactment of the Franchise Tax Law by the legislature in 1899. This law which is designed to subject to annual taxation the full value of the franchises of corporations making use of the streets and avenues of cities, is far more sweeping in its provisions than any of the laws heretofore enacted, which provide for levying contributions based on either gross or net receipts or earning power on any form. If it is found to operate satisfactorily it will undoubtedly supplant the latter method of taxing franchises. The law itself provides that corporations subject to this franchise tax shall be entitled to deductions for amounts paid locally by way of percentages on earnings, etc. It is manifest that if this substitution in the method of assessment should become general, the whole question now under consideration would become of merely academic interest, and the collection of taxes on franchises would be immeasurably simplified.